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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 148

MARINE NATIONAL EXCHANGE BANK OF MILWAUKEE and WEST SIDE BANK,

Petitioners and Appellants below,

vs.

KALT-ZIMMERS MAUFACTURING COMPANY and M. H. GROSSMAN, Trustee in Bankruptcy,

Respondents and Appellees below.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

IRVING A. FISH,

324 East Wisconsin Avenue,
Milwaukee, Wisconsin,

Counsel for the Respondent
KALT-ZIMMERS MANUFACTURING COMPANY.

INDEX

Subject Index

Page

Summary statement of the matter involved 1

The courts below did not pass on the negotiability or non negotiability of the bonds involved 2

The district court found that the petitioners accepted the bonds in bad faith in fact 2

The court of appeals followed this finding 3

Summary of the argument 3

Point A. The decision of the Circuit Court of Appeals for the Seventh Circuit was based on a finding of fact, not the decision of a question of local law 3

The writ should not issue unless the decision of the court of appeals is in conflict with local decisions 4

What was said in the court of appeals as to the case of Pollard vs. Tobin, 211 Wis. 405, did not effect a determination of the case at bar.. 4

The court of appeals found bad faith as a matter of fact. The Tobin case did not so find.... 4

The fact that the Tobin case is criticised by the court of appeals in *obiter dicta does not necessitate* the issue of the writ of certiorari 4

Point B. The decision of the court of appeals was not made on a determination of the meaning of the Wisconsin negotiable instrument act but on general principles of equity and was not in conflict with the law of Wisconsin 5

Page

The district court and the court of appeals decided the case on the general principles of trusts laid down in Jaudon vs. Duncan, 15 Wall. 165, not on any question of local law.... 5

This rule is recognized by the Supreme Court of Wisconsin and is not contrary to the decision in Pollard vs. Tobin, 211 Wis. 405.... 6

Table of Cases Cited

Jaudon vs. Duncan, 15 Wall. 165 ..... 3, 5

Pollard vs. Tobin, 211 Wis. 405 .....3, 4, 5, 6

Whitford vs. Moehlenpah, 196 Wis. 10 ..... 3, 6

Statute Cited

Section 116.61, Wisconsin statutes, 1929 2

Rule Cited

Supreme Court Rule 38, sec. 5, subsec. b 4

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 148

In the Matter of HACKETT, HOFF & THIERMANN, INC., Bankrupt.

MARINE NATIONAL EXCHANGE BANK OF MILWAUKEE and WEST SIDE BANK,

Petitioners and Appellants below,

vs.

KALT-ZIMMERS MAUFACTURING COMPANY and M. H. GROSSMAN, Trustee in Bankruptcy,

Respondents and Appellees below.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

I

SUMMARY STATEMENT OF THE MATTER INVOLVED.

It is thought that an error exists in the petitioners' statement of the issues involved. The petitioners took

Refunding bonds issued by the respondent, Kalt-Zimmers Manufacturing Company, which provided that the trust deed should be referred to, as if recited at length, for the rights of the holders of the bonds and the terms upon which the bonds were issued and held. (Opinion of the Circuit Court of Appeals, R. 96.) The trust deed provided that the bonds and their proceeds should be held by the trustee in trust for certain specified purposes (R. 96). The trustee pledged the bonds it held in trust with the petitioners to secure its personal debts. The petitioners say, on page 2 of the petition for a writ of certiorari, that the issues were (1) Whether the bonds were negotiable instruments, and (2) Whether the petitioners were holders in due course. The district judge and the circuit court of appeals did not decide whether or not the bonds were negotiable. Both these courts held that the petitioners were not holders in due course.

The negotiable instrument act involved is section 116.61 of the Wisconsin statutes. It is quoted in full on page 2 of the petition for writ of certiorari and provides that the knowledge which must be shown to defeat a holder is "actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith."

The district court found that the banks had such knowledge (R. 79). The district court says:

> * * * "The infirmity of the banks' position arises out of their knowledge that the bankrupt trustee was tendering the bonds for its personal benefit. In my judgment such infirmity is declared upon principles of trust powers—or as Justice Story put it—in the 'stubborn rule of equity' forbidding trustees (and all who know of the trust) from dealing in trust property for the personal benefit of the former."

The circuit court of appeals said (R. 100):

> * * * "There were present the means of knowledge and the duty of using them, and as stated in the Hood case (*Cordova v. Hood,* 84 U. S. 1), they were equivalent to knowledge itself. If this does not constitute actual knowledge within the meaning of the Hood case, it presents a very strong case of constructive knowledge which in our opinion amounts to bad faith under the Wisconsin statute."

II

ARGUMENT

Summary of the Argument

POINT A. THE DECISION OF THE CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT WAS BASED ON A FINDING OF FACT, NOT THE DECISION OF A QUESTION OF LOCAL LAW.

POINT B. THE DECISION OF THE COURT OF APPEALS WAS NOT MADE ON A DETERMINATION OF THE MEANING OF THE WISCONSIN NEGOTIABLE INSTRUMENT ACT BUT ON GENERAL PRINCIPLES OF EQUITY AND WAS NOT IN CONFLICT WITH THE LAW OF WISCONSIN.

Pollard v. Tobin, 211 Wis. 405
Jaudon v. Duncan, 15 Wall. 165
Whitford v. Moehlenpah, 196 Wis. 10

POINT A.

The decision of the Circuit Court of Appeals for the Seventh Circuit was based on a finding of fact, not the decision of a question of local law.

In order to require the issue of a writ of certiorari (Rule 38, sec. 5, subsec. b), it is incumbent upon the petitioner to show that the circuit court of appeals has decided an important question of local law in a way probably in conflict with applicable local decisions, or has decided an important question of general law in a way probably untenable or in conflict with the weight of authority. The petitioners point to the case of *Pollard v. Tobin,* 211 Wis. 405, as indicating that the decision is probably contrary to what would be decided by the Wisconsin court on a question of local law. It is true that had the circuit court of appeals decided on the question of negotiability it would as indicated by its opinion have decided contrary to the Wisconsin decision of *Pollard v. Tobin,* 211 Wis. 405, but it did not pass on that question.

The matter of good or bad faith was not determined as a question of law in either case but as a question of fact. In the *Tobin* case there had been some inquiry and some effort to ascertain the situation of the trustee. In the case at bar there was none. In the *Tobin* case the court said at page 411 of the Wisconsin report:

> "The trial court did not find bad faith and there is nothing in the evidence to support a finding of such evidentiary facts as to justify a finding that its action in taking the bonds amounted to bad faith."

The circuit court of appeals indicated that it would have found that the facts in the *Tobin* case were not adequate to show that the presumption of bad faith arising from the pledge of the bonds for the personal debt of the trustee was rebutted. However, it cannot be the intention of the rule that this court will review the *obiter dicta* of the circuit court of appeals as to apparently erroneous decisions of the state courts. It cannot

be urged that the facts in this case were not sufficient to support the finding of bad faith made by the district judge and by the court of appeals. It is submitted that there is involved here only a question of fact and inferences of fact which do not justify the issuance of a writ of certiorari.

POINT B.

The decision of the court of appeals was not made on a determination of the meaning of the Wisconsin negotiable instrument act but on general principles of equity and was not in conflict with the law of Wisconsin.

The decision of the circuit court of appeals was not founded on a decision of a question of local law but on the general principles of equity, as to which it was not bound to follow the Wisconsin court but was required to follow the general common law.

The *Tobin* case decided that the bonds in question are negotiable. The circuit court of appeals, on page 97 of the Record, said:

> "The District Court did not pass on the question of negotiability, but held that the banks were not holders in due course; that even though the bonds were negotiable, that alone was insufficient to excuse the banks from inquiry concerning the trustee's power to pledge them for what the banks knew was the trustee's personal indebtedness."

It then discussed the principles on which the opinion of the district court as to trusts and trust funds is based. The principle which it applied is the one stated in *Jaudon v. Duncan,* 15 Wall. 165, that one who takes property which he knows is held in trust, in pledge for the personal debt of the trustee, takes it subject to the rights of the *cestui que trust.* This is a general principle of equity and depends on no statute. Whether or not the circuit court of appeals was bound to follow the Wis-

consin court in its interpretation of the Wisconsin negotiable instrument act, it was certainly not bound to disregard the opinions of this court, and of the Supreme Court of Wisconsin as well, which established this principle of equity, because the principle was not applied by the Supreme Court of Wisconsin to a case to which it might have been applied had it been mentioned.

The rule of equity on which this case turned was not called to the attention of the Wisconsin court in the *Tobin* case and was not passed upon. An examination of the opinion of that court will show that it is assumed that the trustees had a right to pledge the bonds. *Pollard v. Tobin,* 211 Wis. 405, 411. The case does not therefore repudiate the rule as to the wrongful pledge of trust assets, and it is not apparent that had the rule been brought to the attention of the Wisconsin court the Wisconsin court would not have reached the same conclusion that the court of appeals reached. It cannot be assumed that the Wisconsin court would have overruled its prior decisions (*Whitford v. Moehlenpah,* 196 Wis. 10, 24) had it known that the pledge was in fact not authorized. If the Wisconsin court had expressly held that a pledge of trust assets to the personal account of the trustee was lawful the circuit court of appeals would not be justified in following that decision contrary to the long established rule in this court and the established rule in the courts of the other states.

It is respectfully submitted that there is no occasion for the issue of the writ of certiorari.

Respectfully submitted,
IRVING A. FISH,
Counsel for the Respondent
KALT-ZIMMERS MANUFACTURING COMPANY.